BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on : 12.12.2019
Date of Decision: 28.1.2020

Appeal No.115 of 2019

The Canning Industries Cochin Ltd.
(CIN:U01122KL1947PLC000257)
Having its registered office at
234-32 Caico Road, Valarkavu,
Trichur, Kerala – 680 006. …. Appellant

Versus

Securities and Exchange Board of India
SEBI Bhawan, Plot No.C-4A,
G-Block, Bandra Kurla Complex,
Bandra (E), Mumbai – 400 051. … Respondent

Mr. Srikant Mohan, Practising Company Secretary i/b. Mohans & Associates for the Appellant.

Mr. Fredun DeVitre, Senior Advocate with Mr. Mihir Mody and Mr. Shehaab Roshan, Advocates i/b. K. Ashar & Co. for the Respondent.

CORAM: Justice Tarun Agarwala, Presiding Officer
Dr. C.K.G. Nair, Member
Justice M.T. Joshi, Judicial Member

Per : Justice Tarun Agarwala

1. The present appeal has been filed against the order dated 18th March, 2019 passed by the Whole Time Member (WTM), Securities and Exchange Board of India (hereinafter referred to as 'SEBI') issuing various directions under

section 11, 11(4), 11A, 11B and 19 of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as 'SEBI Act'). The directions so issued are extracted hereunder:-

> *"a. CAICO shall cancel the FCDs as mentioned in paragraph 46 of this order, and forthwith refund the money collected till date through the issuance of FCDs including the application money collected from investors, pending allotment of securities, if any, with an interest of 12% per annum from the date of collection of funds to the investors till the date of actual payment. No such interest shall be paid to Mr. Chiriankandath Palu Jose and Mr. Vadakken Raphael.*
>
> *b. The repayments and interest payments to investors shall be effected only through Bank Demand Draft or Pay Order both of which should be crossed as "Non-Transferable".*
>
> *c. CAICO and its present directors viz., Mr. Chiriankandath Palu Jose, Mr. Paul Thalokaren Timothy, Mr. Mazhuvancheriparambath Kuriakose Aelias, Mr. Chiriyankandath George Joy, Mr. Jessy Pavoo, and Mr. Paul Ovungal Raphael (on behalf of the Company) are directed to provide a full inventory of all the assets and properties and details of all the bank accounts, demat accounts and holdings of mutual funds/shares/securities, if held in physical form and demat form, of the company.*
>
> *d. CAICO and its present directors viz., Mr. Chiriankandath Palu Jose, Mr. Paul Thalokaren Timothy, Mr. Mazhuvancheriparambath Kuriakose Aelias, Mr. Chiriyankandath George Joy, Mr. Jessy Pavoo, and Mr. Paul Ovungal Raphael (on behalf of the Company) are prevented from selling the assets of the Company except for the sole purpose of making the refunds as directed above and deposit the proceeds in*

an Escrow Account opened with a nationalized Bank. Such proceeds shall be utilized for the sole purpose of making refund/repayment to the investors till the full refund/repayment as directed above is made.

e. CAICO, its present directors viz., Mr. Chiriankandath Palu Jose, Mr. Paul Thalokaren Timothy, Mr. Mazhuvancheriparambath Kuriakose Aelias, Mr. Chiriyankandath George Joy, Ms. Jessy Pavoo and Mr. Paul Ovungal Raphael, on behalf for the company shall issue public notice, in all editions of two National Dailies (one English and one Hindi) and in one local daily with wide circulation, detailing the modalities for refund, including the details of contact persons such as names, addresses and contact details, within 15 days of this Order coming into effect.

f. After completing the aforesaid repayments, CAICO and its present directors viz., Mr. Chiriankandath Palu Jose, Mr. Paul Thalokaren Timothy, Mr. Mazhuvancheriparambath Kuriakose Aelias, Mr. Chiriyankandath George Joy, Ms. Jessy Pavoo and Mr. Paul Ovungal Raphael on behalf of the company shall file a report of such completion with SEBI, within a period of three months from the date of this order, certified by two independent peer reviewed Chartered Accountants who are in the panel of any public authority or public institution. For the purpose of this Order, a peer reviewed Chartered Accountant shall mean a Chartered Accountant, who has been categorized so by the Institute of Chartered Accountants of India ("ICAI") holding such certificate.

g. In case of failure of CAICO to comply with the aforesaid applicable directions, SEBI, on the expiry of three months period from the date of this Order may recover such amounts from the company in accordance with section 28A of the SEBI Act including such other provisions contained in securities laws.

h. CAICO is directed not to, directly or indirectly, access the securities market, by issuing prospectus,

offer document or advertisement soliciting money from the public and are further restrained and prohibited from buying, selling or otherwise dealing in the securities market, directly or indirectly in whatsoever manner, from the date of this Order, till the expiry of 4 (four) years from the date of completion of refunds to investors as directed above.

i. Mr. Chiriankandath Palu Jose, Mr. Parappilly Varunny Davis, Mr. Paul Thalokaren Timothy, Mr. Mazhuvancheriparambath Kuriakose Aelias, Mr. Chiriyankandath George Joy, Mr. Jessy Pavoo, Mr. Vadakken Raphael, Mr. Paul Ovungal Raphael and Mr. Ovungal Pyloth Rappai are directed not to, directly or indirectly, access the securities market, by issuing prospectus, offer document or advertisement soliciting money from the public and are further restrained and prohibited from buying, selling or otherwise dealing in the securities market, directly or indirectly in whatsoever manner, from the date of this Order, till the completion of refunds to investors as directed above. The above said directors are also restrained from associating themselves with any listed public company or any public company which intends to raise money from the public, or any intermediary registered with SEBI from the date of this Order till the completion of refunds to investors.

j. Mr. Joseph Chiramel is restrained from accessing the securities market and is further restrained from buying, selling or dealing in securities, in any manner whatsoever, for a period of 4 (four) years from the date of this order. Mr. Joseph Chiramel is also restrained from associating himself with any listed public company or any public company which intends to raise money from the public, or any intermediary registered with SEBI for a period of 4 (four) years from the date of this Order.

k. Other directors of CAICO as on the date of this Order or any other incoming directors of CAICO after the date of this order, shall ensure the repayment on

behalf of the Company by taking steps as mentioned in the previous directions in paragraph 51(a) to (f), as applicable.

l. The above directions shall come into force with immediate effect."

2. The facts leading to the filing of the present appeal is that the appellant is an unlisted Company known as The Canning Industries Cochin Limited (CAICO/Company) incorporated in 1947 and, as on date, has 1929 shareholders. Till 2008, the Company was showing profits and giving dividends but since then has suffered losses and its net worth has been reduced considerably. On 28th September, 2015, in its 68th Annual General Meeting, the Company resolved and passed a special resolution under section 62(3) and 71 of the Companies Act, 2013 read with Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 (hereinafter referred to as 'Debenture Rules') proposing to issue 1,92,900 Unsecured Fully Convertible Debentures (FCDs) of Rs.250/- each to its 1929 shareholders at the rate of 100 FCDs with no right to renounce the offer to any other person. The maturity of the debentures was five years from date of allotment, namely, that every FCD would be compulsorily converted into equity shares on maturity or earlier if the call option is

exercised by the Company. No call option was given to the shareholders. The purpose specified in the explanatory statement was requirement of funds for automation of packing drinking water projects, advertisements, sales promotion of this project and for working capital requirements. By this resolution, the Company sought to raise Rs.25,000/- from each shareholder totaling Rs.4,82,25,000. However, the subscription raised through these FCDs was only Rs.2,83,50,000/- from 335 members.

3. The said proposal was questioned by one disgruntled shareholder who filed an application before the Company Law Board. No interim order was passed on the ground that there was no urgency. This shareholder, namely, Niraj Paul took this matter up by filing an appeal, being Company Appeal no.7 of 2015, which was dismissed by the High Court of Kerala by a judgement dated 8.10.2015.

4. Certain complaints were received by SEBI including ROC in respect of these FCDs. SEBI undertook an enquiry to ascertain whether the Company had made any public issue of securities without complying with the provisions of the Companies Act, 2013. Pursuant to the enquiry, SEBI passed

an ex-parte interim order dated 9th August, 2017 observing that the offer of FCDs by the Company and subsequent allotment were deemed public issue of securities under Section 42 of the Companies Act, 2013 read with Rule 14(2)(b) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (hereinafter referred to as Securities Rules, 2014). It was observed that the requirement under Section 40 of the Companies Act, the relevant provisions of the SEBI Act and Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (hereinafter referred to as 'ICDR Regulations') were not complied with by the Company in respect of the offer of FCDs and, therefore, a slew of directions were issued against the Company and its present and past directors directing them and the Company to cease mobilization of fresh funds from investors through offer of FCDs, etc. The said interim order was subsequently discharged by an order dated 12th July, 2018 holding that the Company and its directors had not violated the provisions of the Companies Act or of the SEBI's Securities Laws and Regulations. The order of the WTM dated 12th July, 2018 was questioned by the same

shareholder Niraj Paul by filing an appeal before SAT being Appeal no.476 of 2018. The said appeal was disposed of by an order dated 18th December, 2018 on the statement made by the counsel for SEBI that they would relook into the entire issue afresh and would pass fresh orders after hearing all parties concerned. The matter was accordingly remitted to the WTM who has now passed the impugned order.

5. The WTM in the impugned order held that the offer to 335 persons is a deemed public issue in violation of Section 42(1) of the Companies Act and Rule 14(2)(b) of the Securities Rules. The WTM further held that the FCDs are covered under the expression of 'shares or other securities' as per explanation (ii) of Rule 13 of the Debenture Rules which mandates compliance of conditions stipulated under section 42 of the Companies Act and is also applicable to issue of FCDs on a preferential basis to existing members of the Company. The WTM held that the offer of FCDs made by the Company was to more than 200 persons and, therefore, the same is deemed to be a public issue under Section 42(4) of the Companies Act read with Rule 14(2)(b) of the Securities Rules. The WTM further held that since the offer

of FCD is deemed to be a public issue the Company was required to comply with the Companies Act and the SEBI Act in as much as the Company failed to make an application to one or more of the stock exchanges and that the prospectus was required to state the name of such stock exchange as per section 40(1) and (2) of the Companies Act. Further, the Company failed to get the money so received from the public through subscription in the escrow account as per section 40(3) of the Companies Act. The Company further failed to comply with the requirement of ICDR Regulations with regard to the allotment of FCDs.

6. We have heard Shri Mr. Srikant Mohan, Practising Company Secretary for the Appellant and Mr. Fredun DeVitre, Senior Advocate assisted by Mr. Mihir Mody and Mr. Shehaab Roshan, Advocates for the Respondent.

7. The contention of the appellant is, that Section 42 of the Companies Act is not applicable in the instant case and that the issue of the share capital is under Section 62(3) of the Companies Act which has not been considered.

8. On the other hand, the contention of the learned senior counsel for SEBI is, that since the offer of FCDs was for

more than 200 persons the said offer is a deemed public offer and therefore part one of the Chapter 1 of the Companies Act is required to be followed.

9. In order to appreciate the submission of the parties it would be essential to peruse certain provisions of the Companies Act and the Rules framed thereunder. Section 42 of the Companies Act provides as under:-

> *42. Offer or invitation for subscription of securities on private placement.*
>
> *(1) Without prejudice to the provisions of section 26, a company may, subject to the provisions of this section, make private placement through issue of a private placement offer letter.*
>
> *(2) Subject to sub-section (1), the offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, (excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62), in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.*
>
> *Explanation I.—If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public*

and shall accordingly be governed by the provisions of Part I of this Chapter.

Explanation II.—For the purposes of this section, the expression—

(i) "qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 as amended from time to time.

(ii) "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section.

(3) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

(4) Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992) shall be required to be complied with.

(5) All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

(6) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the

application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day:

Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

(a) for adjustment against allotment of securities; or

(b) for the repayment of monies where the company is unable to allot securities.

(7) All offers covered under this section shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

(8) No company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

(9) Whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

> *(10) If a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.*

10. A perusal of the aforesaid provision indicates that a Company may make an offer or invitation for subscription of securities on private placement. However, such offer or invitation for subscription of securities cannot exceed 50 persons or such number as may be prescribed. Sub-clause (4) of section 42 provides that if an offer of investment exceeds the prescribed restriction of 50 persons then it shall be treated as a public offer in which case all the provision of the Companies Act, SEBI Act, SCRA Act would be required to be complied with. Explanation II to Section 42(1) defines the expression 'private placement' as an offer of securities or invitation to subscribed securities to a select group of persons by a company through issue of private placement offer letter which is other than by way of a public offer. Rule 14 of the Securities Rules prescribes the procedure for subscription of securities on private placement. The said provision is extracted as under:-

14. Private Placement.— (1)(a) For the purposes of sub-section (1) of section 42, a company may make an offer or invitation to subscribe to securities through issue of a private placement offer letter in Form PAS-4.

(b) A private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons in accordance with sub-section (7) of section 42:

Provided that no person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

(2) A company shall not make a private placement of its securities unless –

(a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations:

Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed:

Provided further that in case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

(b) such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year:

Provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

Explanation.– For the purposes of this sub-rule, it is hereby clarified that –

(i) the restrictions under sub-clause (b) would be reckoned individually for each kind of security that is equity share, preference share or debenture;

(ii) the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;

(c) the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;

(d) the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received:

Provided that monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

(3) The company shall maintain a complete record of private placement offers in Form PAS-5:

Provided that a copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

Explanation.- For the purpose of this rule, it is hereby clarified that the date of private placement offer letter shall be deemed to be the date of circulation of private placement offer letter.

(4) A return of allotment of securities under section 42 shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing-

(i) the full name, address, Permanent Account Number and E-mail ID of such security holder;

(ii) the class of security held;

(iii) the date of allotment of security;

(iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

(5) The provisions of clauses (b) and (c) of sub-rule (2) shall not be applicable to-

(a) non-banking financial companies which are registered with the Reserve Bank of India under Reserve Bank of India Act, 1934; and

> *(b) housing finance companies which are registered with the National Housing Bank under National Housing Bank Act, 1987,*
>
> *if they are complying with regulations made by Reserve Bank of India or National Housing Bank in respect of offer or invitation to be issued on private placement basis:*
>
> *Provided that such companies shall comply with sub-clauses (b) and (c) of sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.*

11. Rule 14(2)(b) prescribes that such offer or investment shall not be made to more than 200 persons. Thus, though Section 42 prescribes a restriction to 50 persons the number has been increased by Rules to 200 persons.

12. In our opinion, Section 42 of the Companies Act read with Rule 14(2)(b) of the Securities Rules is not applicable to the offer of FCDs by the Company as it is not a private placement. Private placement as per Explanation II(ii) of Section 42 means an offer of securities to subscribe securities to a select group of persons by a Company which is other than by way of a public offer through a public issue, rights issue, employee stock option scheme bonus shares, etc.

13. The term "select group of persons" though not defined under the Act indicates a specified number of persons. In the

instant case, the offer of FCDs has been made only to the shareholders of the Company and to none else. The offer of shares to the Company's shareholders cannot be termed as an offer to a 'select group of persons'. The expression "select group of persons" is not a technical expression but has to be understood in its ordinary popular sense, namely, an offer made privately such as to friends and relatives or a selected set of customers distinguished from approaching the general public or to a section of the public by advertisement, circular or prospectus addressed to the public. Thus, the restriction of subscription of shares to 200 persons or more is not applicable in the instant case as it is not a private placement. Thus, section 42 read with Rule 14(2)(b) of the Securities Rules are not applicable in the instant case.

14. Section 62 of the Act is attracted only when a Company wants to increase its subscribed capital by allotment of further shares. The said section provides for issue of rights issue to existing equity shareholders. It also provides for issuance of shares to employees under employees stock option scheme and issue of shares on preferential basis. For

facility, section 62 of the Companies Act, 2013 is extracted hereunder:-

> ***62. Further issue of share capital***
>
> *(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered—*
>
> > *(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—*
> >
> > > *(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;*
> > >
> > > *(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person;*
> > > *and the notice referred to in clause (i) shall contain a statement of this right;*
> > >
> > > *(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not*

dis-advantageous to the shareholders and the company;

(b) to employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or

(c) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

(2) The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be despatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

(3) Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

(4) Notwithstanding anything contained in sub-section (3), where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms

and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion:

Provided that where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

(5) In determining the terms and conditions of conversion under sub-section (4), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

(6) Where the Government has, by an order made under sub-section (4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under sub-section (4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

15. If a company having a share capital at any time wishes to increase its subscribed capital by the issue of further shares, then the Company has to comply with the provisions of Section 62 of the Act. Section 62 of the Act is not

applicable to a private Company. This means that any such Company may offer its further issue of capital to any person or in any manner as it thinks best in its own interests.

16. Thus a perusal of Section 62(1)(a) indicates that a Company having a share capital at any time proposes to increase its subscribed capital by issue of further shares then such shares shall be offered to persons who on the date of the offer are holders of equity shares of the Company in proportion to the paid up share capital of those shares.

17. Section 62(1)(b) provides for issuance of shares to employees under a scheme of employee stock option and Section 62(1)(c) provides for issuance of shares by a special resolution to those persons which may include persons referred to in clause (a) or (b).

18. The WTM has considered the provisions of Section 62(1)(c) read with Rule 13 of the Debenture Rules to hold that the said provision is not applicable and even if the said provision was applicable the requirements of Section 42 was required to be complied with and one such requirement is that the shares cannot be issued to more than 200 persons.

19. In our opinion the provision of Section 62(1)(c) is not applicable in the instant case as it is not a case of issuance of preferential shares but is a case of increase of the subscribed capital of the Company caused by the exercise of an option as a term attached to the debentures issued by the Company to convert such debentures into shares of the Company.

20. This leads us to determine whether the provision of Section 62(3) is applicable in the instant case or not. If the Company has a share capital and wishes to increase its subscribed capital by the issue of further shares, then the Company has to comply with the provisions of Section 62 of the Companies Act, 2013.

21. Section 62(1)(a) of the Act confers preemptive rights on existing equity shareholders, yet clauses (b) and (c) of Section 62(1) allow issuance of further shares to employees and other persons subject to the conditions prescribed. For allotment of shares under Section 62(1)(b), the conditions prescribed under Rule 12 of the Debenture Rules is to be followed. For allotment of preferential shares under Section 62(1)(c), Rule 13 of the Debenture Rules is to be followed. Such increase of the share capital is through the provisions of

Section 62(1)(a), (b) and (c) read with relevant Rules provided for such purposes. Section 62(3) is an exception to Section 62 and excludes increase in the subscribed capital of the Company pursuant to an option attached to the debenture issued by the Company for conversion of such debentures into shares of the Company on the condition that the terms of issue of such debentures has been approved by members by means of a special resolution. The provisions of Section 62 would not apply in relation to convertible debentures into shares of the Company if the following condition is satisfied, namely, that the terms of issue of debentures has been approved by the Company by a special resolution. It may be noted here that under Section 62 of the Companies Act, a Company is under an obligation, when it proposes to issue further capital, to offer such capital to its own shareholders. In regard to debenture stocks or loans which are convertible into shares, the restrictions contemplated under Section 62 will not apply. Section 62(3) is an exception to the other provisions of Section 62. However other conditions contemplated under Rule 18 of the Debenture Rules are required to be complied with.

22. In the instant case, we find that the shareholders in their 68th Annual General Meeting held on 28th September, 2015 passed a special resolution to allot and issue 1,92,900 Fully Convertible Debentures of Rs.250/- with the condition that the shareholders will have no right to renounce the offer in favour of any person and that these debentures would be mandatorily converted into shares upon maturity. Thus, we find from the resolution that the increase in the subscribed capital of the Company was caused by the exercise of an option which was a term, namely, a condition that the issuance of the debentures cannot be renounced in favour of any other person. Thus, we find that the provision of Section 62(3) was duly complied with by the Company and was fully applicable. Further, there is nothing to indicate that the conditions mentioned in Rule 18 were not complied with. In fact the WTM has failed to notice this provision.

23. Once this provision is applicable which is an exception to the issuance of share capital under Section 62 the same is not a public offer and, therefore, the provisions of part I of Chapter III of the Companies Act are not applicable. Accordingly, the provisions of Section 40 which are required

to be complied with in case of a public issue is not required to be followed as in the instant case we find that the issuance of FCDs by the Company was not a public issue and the Company was not mandated to comply with the requirement of public issue under Part I of Chapter 3 of the Companies Act. We further find that the Company had passed a special resolution under Section 62(3) read with Section 71 in respect of issuance of FCDs. The prospectus and the explanatory statement clearly state that the only members holding equity shares were eligible for allotment. It is clear that the offer of FCDs was made to the existing shareholders of the Company. Consequently, the Company was not required to ensure compliance with the limit of allottees as applicable in the case of private placement of securities.

24. There is another aspect. It seems that the WTM was enamoured with the provisions of Section 42 and 62(1)(2) and fortified her findings by referring to Rule 13 of the Debenture Rules and 14(2)(b) of the Securities Rules. The WTM went to the extent of quoting these Section and Rules in extenso but failed to quote or even look into the provisions of section 62(3), 71 and Rule 18 of the Debenture Rules.

Had any effort been made to consider these provisions, there would be no doubt that a different conclusion would have been arrived at instead of brushing aside with the observation "the trigger for action in the present case in offer of FCDs itself and not of exercising an option to convert a debenture into shares of the Company". Clearly, the WTM has not understood the import of the exception clause, namely Section 62(3). We find that the WTM was more enamoured with the restriction of 200 persons contemplated in Section 42 and Rule 14(2)(b) of the Securities Rules and revolved its order around these provisions.

25. In this regard, Section 71(5) of the Companies Act is extracted hereunder:-

> *(5) No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.*

26. A perusal of the aforesaid provision indicates that no offer can be made to its members exceeding 500 for the subscription of its dentures unless the Company, before such offer or issue has appointed a trustee. Thus, the restriction is

that debentures could be issued to only 500 persons if there is no trustee appointed by the Company. However the restriction of 500 persons is done away if a trustee was appointed by the Company. In the instant case, it is an admitted fact that a trustee was appointed. Thus there was no restriction to the number of shareholders to whom the debentures would be issued.

27. In the light of the aforesaid, the impugned order passed by the Whole Time Member cannot be sustained. The interim order as well as the impugned order and the directions so issued are all quashed. The appeal is allowed. In the circumstances of the case, parties shall bear this own costs.

Sd/-
Justice Tarun Agarwala
Presiding Officer

Sd/-
Dr. C. K. G. Nair
Member

Sd/-
Justice M.T. Joshi
Judicial Member

28.1.2020
Prepared and compared by
RHN